

No. 22,188-A

United States Court of Appeals
For the Ninth Circuit

In the Matter of

E. W. REYNOLDS COMPANY,
Bankrupt.

BEVERLY McCONNELL, and OSCAR STROBEL,
Trustee of the Estate of E. W.
Reynolds Company,

Appellants,

vs.

ESTATE OF W. H. BUTLER, Deceased,
CERTAIN DEBENTURE HOLDERS,

Appellees.

On Appeal from the United States District Court
for the District of Arizona

REPLY BRIEF FOR APPELLANT
OSCAR STROBEL, TRUSTEE OF THE ESTATE OF
E. W. REYNOLDS COMPANY, BANKRUPT

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REPLY BRIEF FOR APPELLANT OSCAR STROBEL, TRUSTEE OF THE ESTATE OF E. W. REYNOLDS COMPANY, BANKRUPT

INTRODUCTION

Appellant stands on the presentation of Facts and Law set forth in his opening Brief. Despite Appellees' professed exceptions to the Appellant's statement, the essential facts in the case are not in dispute. Indeed the litigation is not concerned with the resolution of disputed facts, but rather with the legal effect of the transactions involved.

Although Section 39(a) of the Bankruptcy Act imposes upon the Referee the duty of providing a "transcript of the evidence or a summary thereof" we do not have such a transcript or a summary. All efforts by Appellant to compel the preparation of such a transcript or summary have been unsuccessful. No one regrets this incompleteness of the record more than Appellant, but, nevertheless, we submit that a review of the exhibits which have been transmitted to this Court, and the Findings of Fact which remain unchallenged, will reflect the error of the lower Court's decision.

ARGUMENT

POINT 1

DISALLOWANCE OF DEBENTURE CLAIMS

Appellees' Brief is not responsive to the primary issue in this Appeal, to wit: whether debentures of a corporation issued in payment of repurchase price of its stock, may be enforced if the corporation has no surplus when payment is to be made, and whether when the corporation is in Bankruptcy, holders of such debentures may share on a parity with the corporation's creditors.

Appellees have cited no authority to refute the great volume of cases determining the complete unenforceability of an agreement to repurchase stock in the absence of surplus. The reason is obvious, as on this point, all authorities, whether they be in the corporate, bankruptcy or contract field, concur.

We point out to the Court again that we are not concerned here with the so-called "under capitalization cases", where money is advanced to capital, under the guise of a loan, nor are we concerned with the creditor vs. creditor situation where no investment in capital has ever been intended (such as the *Arnold v. Phillips*; the *In re L. M. Alleman Hardware Co.*; the *Brown v. Freedman*; and the *Kansas City Journal* case as cited by Appellees). And contrary to the suggestion made by Appellees, the approval of the California Division of Corporations of the debenture issue, does not in any way establish or reflect the validity or enforceability of the agreement of the E. W. Reynolds Company to repurchase its own stock (*England v. Christianson*, 243 A.C.A. 478).

There is no dispute that Appellees originally invested in the capital of the E. W. Reynolds Company and received stock therefor; that they agreed to sell and have sold this stock back to the company; that the debentures evidence the agreement of the company to pay them a fixed sum for this stock, and that there is no surplus from which payment can now be made.

POINT 2

SUBORDINATION OF THE CLAIMS

The Courts have established criteria for determining the propriety of subordination; obviously each case must be determined on its own merits. Our Supreme Court has however stated:

“The question to be determined when the plan or transaction which gives rise to a claim is challenged as inequitable, is whether within the bounds of reason and fairness such a plan can be justified.” (*Taylor v. Standard Glass*, 306 U.S. 307, 59 S.Ct. 543.)

Fraud is not a prerequisite to subordination (*Costello v. Fazio*, 356 F.2d 903, 9th C.C.A.).

Here we do know that the debenture claimants were well aware of the financial condition of the E. W. Reynolds Company prior to the time they elected to convert their stock to a debenture; that they realized that they may never receive payment for their stock if the company did not improve its financial condition, but that the alternative was possible loss of the stock due to inability to pay the subscriptions therefor; that the debenture-stock exchange plan offered to them the possibility of recovery of their total investment plus interest, rather than the retention of stock with the uncertainty of dividends; that the debenture claimants did receive the “benefits of their bargain” in that they have recovered a substantial part of this investment, while creditors have not received the benefit of any such bargain; that the debenture holders who invested without the expectation of withdrawal, have partially recovered their investment while the creditors who advanced real value to the company, with full expectation and promise of payment, have received nothing. Surely it is inequitable to allow such claimants now to withdraw funds from the corporation to the detriment of these creditors.

CONCLUSION

Appellant requests that the Court determine that the claims of the debenture holders are "as a matter of substantial economic and legal reality" claims for repayment of capital or proprietary interest, for payment of purchase price of stock sold by them to the corporation, that they are not therefore "debts" and they may not be allowed as a claim in the Bankruptcy Estate; or in the alternative that equity requires such claims to be subordinated to the payment of creditors of the corporation.

Dated, Phoenix, Arizona,
February 19, 1968.

Respectfully submitted,
BEVERLY J. McCONNELL,
Attorney for Appellant
Oscar Strobel.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

BEVERLY J. McCONNELL,
Attorney for Appellant
Oscar Strobel.

